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Spirit of Tax Law and Tax (Non-)Compliance: Reflections on Form and Substance

In complying with their tax duties, multinationals need to align their conduct with both the letter and spirit of the law. The latter requires identifying legislative intent, which is challenging in a rapidly evolving business and tax environment that is increasingly globalized and digitalized. In addition, tax avoidance legislation is increasingly being employed against aspects of non-compliance with the spirit of the law. The need for clear legislative drafting arises, therefore, as a necessary guarantee to prevent abusive interpretations.

1. Introduction

According to the OECD Guidelines, multinational enterprises (MNEs) must promptly fulfil their tax obligations so as to effectively contribute to the countries in which they operate. Proper fulfilment means compliance with the letter and the spirit of the tax laws and regulations of the states they operate in.[1] Viewing this obligation from a digital economy perspective, enterprises operating based on digital business models are called to comply with the letter and spirit of tax legislation in (almost) all countries around the world. Remarkably, in the ten areas of business conduct dealt with in the Guidelines – including employment, competition, environment – reference to the spirit of the law is only made in the chapter addressing taxation (Chapter XI).[2]

The obligation to comply with the spirit of tax law is also identified in the context of national legislation. Indicatively, the UK Code of Practice on Taxation for Banks (Banking Code) provides that banking groups with operations in the United Kingdom are expected to "comply with the spirit as well as the letter of tax law, discerning and following the intentions of the Parliament".[3] The same concept underpins the UK policy to boost tax compliance of large businesses. In essence, since 2016, enterprises in the United Kingdom exceeding certain income thresholds have been required to publish their business tax strategy, including their approach to tax planning.[4] At the other end of the spectrum, multinationals seem to react positively to such legislative requirements, integrating into their codes of conduct and/or public reports elements on tax strategy and compliance with the spirit of the law.[5]

Even more important – and definitely unprecedented – is the action being taken in the area of enforcement, i.e. actually catching and punishing those who do not comply with the spirit of tax law, but only with its letter, commonly known as tax avoiders. There is, in fact, an ongoing worldwide fight against tax avoidance[6] taking shape through a number of international projects. The OECD and G20's Base Erosion and Profit Shifting (BEPS) initiative,[7] as well as its European twin, the Anti-Tax-Avoidance Package (ATAP),[8] are two of the more representative ones. Under this framework, several rules have been (and are still

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1. OECD, *OECD Guidelines for Multinational Enterprises* (OECD 2011), ch. XI, available at https://www.oecd.org/corporate/mne/48004323.pdf.
2. Such a distinctive reference may be due to an unprecedented global effort to mitigate tax avoidance and evasion, reflected in the OECD Base Erosion and Profit Shifting (BEPS) Project and similar actions at a national and regional level. The spirit of the law seems to constitute *ultimum refugium* (a last resort) of the world's legislatures to impose effective taxation in totally adverse circumstances. Further details on the said effort are provided herein.
3. UK: Code of Practice on Taxation for Banks Policy Paper, 2013, sec. 5.1 [hereinafter "UK Banking Code"].
4. The description of the attitude towards tax planning is expected to include details on (i) the business code of conduct (if any), (ii) the reasons for seeking external tax advice and the tax planning motives, as well as their impact on the adopted strategy and (iii) where applicable, the group's approach to tax planning. *See* HM Revenue & Customs (HMRC), Large Businesses: Publish Your Tax Strategy Guidance (24 June 2016), available at https://www.gov.uk/guidance/large-businesses-publish-your-tax-strategy (accessed on 30 Nov. 2017).
5. UBS's Code of Conduct and Ethics includes an explicit reference to the fact that the bank's tax reporting "complies with the spirit as well as the letter of any applicable laws, regulations or treaties". *See* UBS, *The way we do business: Our Code of Conduct and Ethics* p. 7 (UBS 2017). Similarly, Japanese computer display manufacturers, in their Corporate Social Responsibility (CSR) report, have made a commitment to maintain "strict respect and compliance with both the letter and the spirit of the law". *See* EIZO NANAO Corporation, *Corporate Social Responsibility Report 2012* sec. 6 (Oct. 2012), available at http://www.eizoglobal.com/company/csrreport/CSR2012e.pdf (accessed on 30 Nov. 2017).
6. According to Prof. K. Brown, tax avoidance involves the "arrangement of a transaction to obtain a tax advantage, benefit or reduction in a manner unintended by the law. It is an unacceptable manipulation of the law". *See* K. Brown, *Comparative Regulation of Corporate Tax Avoidance: An Overview*, in *A Comparative Look at Regulation of Corporate Tax Avoidance* (K. Brown ed., Springer 2012). Due to the breadth of the term and the uncertainty as to its precise definition, it is important to draw a line between acceptable and unacceptable behaviours considered in the context of avoidance. *See* sec. 3.
7. The BEPS Project was launched in 2013 with the OECD Report, *Addressing Base Erosion and Profit Shifting* (OECD 2013), International Organizations' Documentation IBFD, seeking to identify cases where domestic and international tax rules were not aligned with modern business means and procedures and facilitated tax avoidance.
8. The ATAP envisaged, amongst others measures, assisting Member States to take strong and coordinated action against tax avoidance and ensure alignment of tax payment with value creation in the European Union. *See* Communication from the Commission to the European Parliament and the Council on Anti-Tax Avoidance Package: Next Steps Towards Delivering Effective Taxation and Greater Tax Transparency in the EU, COM(2016) 23 final (28 Jan. 2016), EU Law IBFD.

being) discussed and introduced to curb avoidance at a national and international level.[9]

In these circumstances, there is clear pressure, primarily on large multinationals, but also on the whole business community, to demonstrate compliance with the spirit of the law. The main risks associated therewith are (i) non-compliance with legal obligations, depending on the specific framework of each jurisdiction and (ii) damage to reputation. Nevertheless, there is also the risk of competitive disadvantages vis-à-vis market competitors, taking into account the increasing importance of cooperative relations between taxpayers and tax authorities in many advanced economies.[10] Insufficient proof of compliance with the spirit of the law could undermine such cooperation and deprive enterprises of the procedural and substantive benefits of cooperative compliance regimes.

In view of the above, this article seeks to explore the essence of the phrase "spirit of tax law" and the manner of ensuring fulfilment of the specific obligations connected therewith. To this effect, it begins by addressing the clarifications given by national and international legislatures on the notion (section 2.). It then continues with an overview of important rules enacted worldwide to curb incidents of non-compliance with the spirit of the law (anti-tax avoidance rules) (section 3.), as well as the "form versus substance" debate generated therefrom (section 4.). Subsequently, this article examines aspects of non-compliance with the spirit of the law not captured by the above rules (section 5.). It concludes by identifying the limits of the notion (section 6.) and suggesting potential alternatives (section 7.).

2. The Spirit of Tax Law as per Legislation

The question that naturally comes to mind once confronted with the obligation to comply with the spirit of tax law is what the spirit of tax law is and how one should act to ensure compliance therewith. In order to respond to this question, the first step is to verify the explanations and indications given in national and international legislation.

In the Guidelines for MNEs, the OECD specifies that a taxpayer complies with the spirit of the law, if he "takes reasonable steps to determine the intention of the legislature and interprets [the respective tax law] consistent with that intention in light of the statutory language and relevant contemporaneous legislative history".[11] Hence, the spirit of the law, for the OECD, is the purpose of the legislative body; there is compliance where there is a real effort to apply tax law according to its purpose. There are two additional elements. Firstly, reference to the spirit of the law does not justify a tax liability beyond the amount stated in the law. Secondly, alignment of tax liability with economic substance is an essential element for adherence to the spirit of the law; where there is a legal exception, the taxpayer is expected to "reasonably believe" in his interpretation of the legislative will.

Similar input is provided by the UK tax administration (Her Majesty's Revenue and Customs, HMRC) as regards the respective obligation at a national level: once again, taxpayers[12] must discern and follow the parliament's intentions. Apart from explaining compliance with the law's spirit, similarly to the OECD, as above, HMRC analyses acceptable tax planning. Taxpayers are required – amongst other things – to ensure that any and all tax planning leads to tax results in line with legislative purpose. In other words, the organization of tax affairs is not, in itself, condemned but is conditional upon the existence of a "genuine commercial activity", i.e. economic substance. Moreover, taxpayers "should consider whether Parliament can realistically have intended" a certain result in respect of facts that are very different from those considered (by the parliament), i.e. "whether the tax consequences of a proposed transaction are too good to be true".[13]

Notwithstanding the aforementioned analyses and examples, there are still pending questions regarding the notion of the spirit of tax law and the specific obligations it comprises.[14] For example, it is not clear what would actually be deemed a "reasonable effort" to identify a legislature's intention. Furthermore, it is questionable whether or not the required standard of "reasonable efforts" could differ depending on the taxpayer, the value of the transaction and the amount of the tax liability. Equally, the degree of precision with which the intention of the legislature can be discerned can vary on a case-by-case basis depending on the available materials and economic developments that have occurred since enactment of the applicable law. Finally, determining what is "too good to be true" seems rather subjective.[15]

3. Negative Approach to the Spirit of Tax Law – Tax Avoidance

3.1. In general

Regardless of the pros and cons, the obligation to comply with the spirit of tax law is – to a large extent – enforceable. Various provisions are either already in effect or under consideration domestically, in several jurisdictions and

9. Such rules include a general anti-avoidance rule (GAAR), abuse of law rules, a principal purpose test (PPT), etc., which will be analysed later in this article.
10. OECD, *Co-operative Compliance: A Framework. From Enhanced Relationship to Cooperative Compliance* (OECD 2013), available at http://www.oecd.org/tax/co-operative-compliance-a-framework-9789264200852-en.htm.
11. *See* OECD, *supra* n. 1, at 60 (para. 1).
12. Since the obligation referred to herein is included in the UK Banking Code, taxpayers in this instance are banking groups, subsidiaries and branches operating in the United Kingdom.
13. M.P. Devereux et al., *Tax Avoidance* p. 15 (Oxford University Centre for Business Taxation 2012), available at https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/TA_3_12_12.pdf.
14. It is worth noting that the notion of the spirit of the law, which dates back to the Christian Bible, has generated one of the longest-standing debates in human history. No widely acceptable definition has, however, been given.
15. For a closer look at the approach of legislatures to – and subsequent their responsibility for – taxation or non-taxation of certain types of income, *see* P. Valente, *Taxless Corporate Income: Balance Against White Income, Grey Rules and Black Holes*, 57 Eur. Taxn. 7 (2017), Journals IBFD.

at the international level, providing a legal basis for condemning violations of the spirit of tax law. The targeted behaviour is widely referred to as tax avoidance. Such a term is deemed to include several types of action with certain common characteristics. In particular, the condemned tax avoidance is held to (i) lead to minimization/reduction of tax liability, (ii) through an unreasonably broad interpretation of tax laws or exploitation of mismatches in the international tax framework, (iii) which, however, do not amount to a violation of the (letter) of the law.[16] Such avoidance behaviour must be distinguished from reasonable and acceptable tax planning, i.e. the arrangement of a taxpayer's affairs so as to use tax breaks, allowances, etc. Interpreted *stricto sensu*, it includes only aggressive tax planning, in particular for the purposes of this article. What such tax avoidance is accused of infringing – which is what makes it "unacceptable" – is the spirit of the law. Legislatures hence seek to catch tax avoiders employing:

- general anti-avoidance rules (GAAR);
- abuse of law rules (AoL);
- principal purpose tests (PPT);
- limitation on benefits clauses (LOB); and/or
- a combination of the above.

Tax avoidance taking place in the context of national law is the target of GAARs and AoL rules.

3.2. GAARs

An illustrative example is the UK GAAR, enacted in 2013 in order to enhance the existing anti-avoidance framework.[17] The scope of the rule includes abusive tax arrangements, i.e. arrangements centred on a tax-related advantage,[18] which are not supported by economic reality. Whether or not there is sufficient economic substance is determined by applying the double reasonableness test.[19] The rule can be applied not only by the HMRC, following a detailed procedure,[20] but also by taxpayers themselves, in a self-assessment context. HMRC decisions are subject to appeal by taxpayers, in which case the burden of proof would fall on the former. Application of the provision can lead to penalties in the event of an inaccurate self-assessment or criminal law sanctions for cheating in respect of public revenue and/or a conspiracy to cheat. In 2016, the European Union introduced similar legislation in the context of the Anti-Tax Avoidance Directive (2016/1164).[21] The European legislature makes reference to non-genuine arrangements, i.e. arrangements not justified on valid commercial grounds supported by economic reality.

3.3. AoL

Another legal instrument targeting tax avoidance is the abuse of law doctrine. Such a rule existed in France long before the introduction of a GAAR in the United Kingdom. On the basis of this concept, tax authorities may ignore and/or recharacterize an arrangement where form is not aligned with substance, i.e. in case of (i) sham arrangements and/or (ii) "purely tax motivated" transactions that challenge the spirit of the law, albeit not its letter.[22] The rule may be invoked by the tax authorities alone (FTA), which must follow specific procedural steps involving an independent AoL Committee. Decisions are, once again, subject to appeal. There are also specific penalties connected with abuse of tax law while there is a broad basis for liability of the parties involved.

At an international level, the PPT and LOB clauses are common tax treaty provisions aimed at curbing tax avoidance enabled by loopholes and mismatches of the international tax framework due to the interaction of uncoordinated national rules. Including a PPT or an LOB clause, or a combination of the two, is a minimum standard for countries adhering to the conclusions of the BEPS Project. Thus, such countries must include relevant provisions in their future tax treaties; in addition, they need to amend their existing tax treaties to the same effect.[23]

3.4. The PPT

The PPT can be described as a GAAR in the context of tax treaties. A comprehensive sample of a PPT clause has been proposed by the OECD within the framework of the ongoing BEPS Project, in particular Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances).[24] It applies once the conditions of a subjective and an objective test are met. As regards the subjective test, it is satisfied in the context of arrangements where it is reasonable to conclude that one of the principal purposes was to achieve a tax advantage. If such a test is satisfied, the objective test applies. It is, in turn, passed if the said arrangements successfully lead to the granting of the tax advantage, but violate the spirit of the relevant treaty provisions.

16. *See* OECD Secretariat, *OECD: Work on Tax Avoidance and Evasion*, 8 Intertax 1 (1980); Communication from the Commission to the European Parliament and the Council on Tax Transparency to Fight Tax Evasion and Avoidance, COM(2015) 136 final (18 Mar. 2015), EU Law IBFD; and Devereux et al., *supra* n. 13, at 4.
17. At that time, the UK anti-avoidance framework comprised, inter alia, (i) targeted anti-avoidance rules (TAARs), (ii) case law, (iii) mandatory disclosure rules (DOTAS), etc. *See The General Anti-Abuse Rule (GAAR): Overview*, Practice Note (Lexis Nexis), available at Lexis Nexis Online (accessed 7 Oct. 2017).
18. Specific taxes are indicated as falling within the scope of the rule: income tax, corporate tax, capital gains tax, inheritance tax, etc.
19. The question to be asked is whether, under the circumstances, entering into/carrying out the arrangement can be regarded as a reasonable course of action in relation to applicable tax laws. *See* Lexis Nexis, *supra* n. 17, at 5.
20. Such a procedure involves a GAAR Advisory Panel, the personnel of which cannot be HMRC personnel.
21. Council Directive (EU) 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, art. 6, OJ L193 (2016), EU Law IBFD [hereinafter "ATAD Directive"].
22. It is worth noting that French case law favours a broad interpretation of the pure-tax-motivation criterion. In addition, abuse of law may be applied in relation to any type of tax.
23. OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2015 Final Report* (OECD 2015), International Organizations' Documentation IBFD [hereinafter *Action 6 Final Report*] and OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties – Action 15: 2015 Final Report* (OECD 2015), International Organizations' Documentation IBFD. *See* P. Valente, *BEPS Action 15: Release of Multilateral Instrument*, 45 Intertax 3 (2017).
24. *Action 6 Final Report*, at 54 et seq.

3.5. LOB clauses

LOB clauses are a widely used alternative to a PPT, but the two can also be effectively combined. LOB clauses are drafted so as to limit the enjoyment of tax advantages arising from treaty provisions granted to "qualified persons", being residents of the contracting states that additionally fulfil a number of qualifying conditions.[25] They target specific features of transactions that have been flagged as potential treaty shopping. They can thus be applied automatically, since they do not demand the kind of interpretation needed under the PPT. The drawback – which is, however, inevitable – is that their scope is narrower. For this reason, many jurisdictions opt for a combination of the PPT with LOB clauses.

4. Tax Avoidance: Substance-over-Form or Form-over-Substance

The inclination of legislatures (and tax administrations) to enact additional and new rules to prevent tax avoidance and urge compliance with the spirit of the law is often not welcomed by other stakeholders. Concerns are increasingly being raised in the literature and case law, in particular regarding the compatibility of these rules with fundamental principles of sound legislation and taxpayer rights. Tax avoidance laws, in principle, seek to identify the substance of taxpayer arrangements and determine proper taxation on the basis of a deemed economic reality, undermining the given form. This necessitates a delicate assessment, which can vary significantly depending on the viewpoint of the user of the law in each instance.

The ongoing debate regards prioritization of substance-over-form or form-over-substance in tax matters. A recent dispute that arose in the United States and was recently brought before the Court of Appeals,[26] is indicative of this issue. The taxpayer used a corporation[27] to transfer money from a family company to individual retirement accounts. US tax authorities noted that such an arrangement – although compliant with the applicable laws, the purpose of which was admittedly to provide a tax advantage – led to evasion of contribution limits in respect of the accounts at issue and should be recharacterized (as a dividend). This view was shared by the Tax Court. Nevertheless, the Court of Appeals overturned the recharacterization arguing that, "the substance over form doctrine does not give the Commissioner a warrant to search through the Internal Revenue Code and correct whatever oversights Congress happens to make or redo any policy missteps the legislature happens to take".[28] Remarkably, reference is made to a 1935 decision that prompted the debate.[29] The view taken at that time was that "anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose the pattern which will better pay the Treasury".

Similar concerns regarding tax avoidance and the limits of the fight against it have been raised in the United Kingdom. Lord Hoffmann (2005) points out that tax avoidance, as a concept, is contradictory.[30] He stresses that legislation is the sole means for legislatures to communicate their purpose to tax an arrangement. Subsequently, the sole body authorized to give effect to such legislation through interpretation, i.e. to outline the spirit of the law, is the Judge. There is no other authority, beyond the legislature and courts, that can construct legislation. Most importantly, it would be dangerous if there were. Such a risk has also been emphasized by Indian courts, which cancelled penalties for an omission in respect of tax returns due to poor wording and hence the arbitrariness of the applicable provision.[31]

Equally fierce is the debate in civil law countries. In 2004, the Polish Constitutional Court rejected a proposal for the introduction of a GAAR finding it incompatible with the principle of the rule of law and the standards for sound legislation.[32] The French *Conseil Constitutionnel* had the same reaction in 2013 when it dealt with a proposal for the introduction of a PPT in place of the existing "exclusive purpose test". It focused on the fact that the proposal necessarily implied wide discretion of the administration to make decisions on the principal purpose of tax arrangements and impose penalties. It held that the proposed amendment would violate three fundamental principles: (i) legality in tax matters, (ii) legality of offences and penalties, (iii) accessibility and intelligibility of the law.[33]

The substance-over-form discussion in the context of tax avoidance reveals a clear message: the concept of tax avoidance – and subsequently of violation of the spirit of the law – is not (yet) crystal clear. It seeks to make illegal what is, on its face, legal, drawing fine lines in the sand between blurred and fluid notions. For the correct application of tax law, it relies on discretionary assessments by tax administrations, the inherent role of which is executive (not legislative). It demands complex assessments

25. A sample LOB clause is provided in the *Action 6 Final Report* as an alternative to PPT clauses or as a possible supplementary provision (id., at 17 et seq.).
26. US: US Ct. App. Sixth Circuit, 16 Feb. 2017, *Summa Holdings v. Commissioner of Internal Revenue*, No. 16-1712.
27. Domestic International Sales Corporation (DISC).
28. Judge Sutton held that the substance-over-form doctrine may only be used "when the taxpayer's formal characterization of a transaction fails to capture economic reality and would distort the meaning of the [Internal Revenue] Code".
29. US: Supreme Court (SC), 7 Jan. 1935, *Gregory v. Helvering*, N. 127.
30. In particular, Lord Hoffmann mentioned that: "Tax avoidance in the sense of transactions successfully structured to avoid a tax which parliament intended to impose should be a contradiction in terms". *See* L.H.H. Hoffmann, *Tax Avoidance*, 2 BTR (2005).
31. IN: Income Tax Appellate Tribunal (ITAT) Bangalore, 21 Dec. 2004, *Nemichand v. Assistant Commissioner* and IN: SC, 11 Mar. 1994, *Kartar Singh v. State of Punjab*.
32. It should be noted, however, that Poland did, in the end, introduce a GAAR effective in 2016. *See* S. Łuczak & K. Gotfryd, *Poland*, in *The Tax Disputes and Litigation Review* (S. Whitehead ed., 5th ed., Law Business Research 2017).
33. According to the third principle, legislation must be so precise so as not to allow misinterpretation. In addition, the separation of powers in the state according to the Constitution must be respected. Where legislatures are assigned legislative drafting, the judiciary and executive branch are not to participate in the legislative process, even by remedying deficiencies. *See* FR: Conseil Constitutionnel (CC), 29 Dec. 2013, *Lois de finances pour 2014* [2014 Budget Law], *2013-685 DC*, *Recueil des décisions du Conseil constitutionnel* 2013 and R. Cunha, *BEPS Action 6: Uncertainty in the Principal Purpose Test Rule*, 1 Global Taxn. 2 (2016).

by taxpayers who are faced with an ever-present risk of being challenged by tax officials. It might be successful in preventing/punishing abusive behaviour, but is costly in terms of tax uncertainty[34] and subsequent restrictions on investment, business, innovation and growth. There is no general consensus on the merits of tax avoidance rules, although they are already part of the legal systems of many jurisdictions.

5. Obligation to Comply with the Spirit of Tax Law and Tax Avoidance Rules

The spirit of tax law, and the obligation to comply therewith, is intrinsic to the concept of tax avoidance, but also implies something more. Tax avoidance is, in effect, a type of non-compliance with the spirit of tax law, which fulfils additional conditions, for example, leads to tax-related benefits, the granting of which needs to have been the main purpose of the tax arrangement under examination.[35] Cases that fall short of these additional requirements do not fall under tax avoidance laws but may still violate the obligation to comply with the spirit of the law. This could explain why legislatures are introducing, or considering the introduction of, obligations in addition to tax avoidance legislation and independent therefrom.[36]

Taxpayers, therefore, need to understand any further obligations that are implied (or that might be implied) in an express legislative reference to the spirit of tax law. To this effect, the thousand-year old discussion on the true meaning of the spirit of the law – in general – becomes relevant. The theories that have been developed[37] seem to converge in identifying the spirit of the law beyond the legal text, based on the principles of a given community that justify and legitimize the purposes set and pursued by its legislatures. It is also commonly held that the spirit of the law is discerned through interpretation, for which purpose materials outside the legal text are to be used (for example, *travaux préparatoires*, other legal provisions or legal precedent).[38] Most importantly, interpretation should be dynamic. It should seek to construe the stance the past legislature would have taken towards the facts of an actual case – at the time of the interpretation – in light of the principles underlying the applicable provision.[39]

Compliance with the spirit of the law can thus be held to require from taxpayers that they apply tax laws to their tax arrangements in a manner similar to what would have been applied by the legislature had the latter encountered such tax arrangements. In the context of a fluid economic reality, which is increasingly becoming digitalized and is expanding into business models never before conceived, this is a very challenging task.[40] Digital business models[41] and arrangements required for their effective operation have not yet been contemplated by tax legislatures.[42] The existing tax laws were drafted without taking into account such a swift development of the economy in this direction. In such a context, compliance with the spirit of tax law requires that taxpayers determine, on their own, what a past legislature would have deemed proper taxation of current (and future) arrangements. In doing so, they do not have sufficient resources to refer to: they have to replace non-existent legislatures and construe, from scratch, the tax laws of the new reality.

In view of the above, the obligation to comply with the spirit of tax law seems to be a particularly wide concept. Taking into account the concerns raised in connection with tax avoidance legislation – an even narrower notion – such an additional obligation may be considered even riskier in terms of uncertainty from a taxation perspective.

6. The Spirit of Tax Law and Likely Risks

While discerning the spirit of the law in the absence of tax law can be demanding, it can be equally difficult in instances where there are specific tax laws. The extent to which the spirit of the law can be accurately interpreted in a straightforward manner depends on the nature of the law in question.[43] Where there is very little consensus on the principles underpinning the law, the views on

34. The existing risk of tax uncertainty was recently confirmed in the Report on Tax Uncertainty compiled jointly by the OECD and the IMF. *See* OECD & IMF, *Tax Uncertainty, IMF/OECD Report for the G20 Finance Ministers*, in *OECD Secretary-General Report to the G20 Finance Ministers* (2017).
35. H. Filipczyk, *Tax Non-avoidance as a Missing Piece of the Puzzle in the CSR Agenda in Poland*, 18 Annales. Ethics in Economic Life 4 (2015).
36. For example, the UK legislature introduced an express obligation to comply with the spirit of tax law for banks in the Banking Code, in spite of the fact that a GAAR was already in place. *See* UK Banking Code, *supra* n. 3, at 1.
37. *See* M. Aronson, *Mr. Justice Stone and the Spirit of the Common Law*, 25 Cornell L. Rev. 4 (1940); S. Levine, *The Law and the "Spirit of the Law" in Legal Ethics*, J. Prof. Law (2015); T. Allan, *Dworkin and Dicey: The Rule of Law as Integrity*, 8 Oxf. J. Leg Stud. 2 (1988); and R. Dworkin, *Law's Empire* (Harvard University Press 1986).
38. According to Justice Stone, "[t]o grasp their significance [of the questions arising with respect to interpretation of laws] our study must be extended beyond the examination of precedents and legal formulas, by reading and research in fields extra-legal, which nevertheless have an intimate relation to the genesis of the legal rules". *See* H. Stone, *Fifty Years of Work of the Supreme Court*, ABA Journal 14 (1928).
39. *See* Dworkin, *supra* n. 37, at 9; a purposive interpretation has been embraced by the UK courts. In *Inland Revenue Commissioners v. Mc Guckian*, Lord Steyn established that "the modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose"; *See* UK: HL, 12 June 1997, *Inland Revenue Commissioners v. McGuckian*, WLR 991.
40. The OECD acknowledges that "sometimes it is extremely difficult to interpret what the spirit of the law is and so it is natural for a revenue body and taxpayer to have different opinions on these matters". Thus multinationals are allowed some margin of deviation within the context of cooperative compliance regimes, provided however that their suggested interpretation is reasoned. *See* OECD, *supra* n. 11, at 3.
41. Digital economy is deemed to include, indicatively (i) participative networked platforms, (ii) sharing/collaborative economy, (iii) online provision of services, (iv) 3D (layered) printing, etc. *See* OECD, *Addressing the Tax Challenges of the Digital Economy – Action 1: 2015 Final Report* (OECD 2015), International Organizations' Documentation IBFD.
42. In fact, the OECD is still working on the tax rules for digital economy in the context of Action 1 of the BEPS Project. The final outcome is expected in 2020. *See* Valente, *supra* n. 15, at 4.
43. Evidence has been provided that social consensus behind the law shall determine the coincidence or distance – larger or smaller – between the spirit and letter of the law. By way of example, the clarity and straightforwardness of the laws' spirit differs (i) in respect of a prohibition against murder and (ii) in respect of a prohibition against assisted suicide. Although everyone can see the value of the former and the relevant intention behind the law, social consensus is far weaker in the latter

its correct meaning will be more divergent and subsequently its proper interpretation will be less certain. In such instances, legislatures have an increased responsibility to use clear and precise wording, specifically with regard to the appropriate interpretation of the provision, to ensure its effective application.

Tax law is regarded as one of the most controversial legal areas, with the result that the debates regarding interpretation can often get heated, for example, with regard to the allocation of taxing rights among jurisdictions, a fair allocation of the tax burden among taxpayers, as well as the very justification for tax obligations.[44] Even within the same jurisdiction there can be (and in principle there is) significant disagreement as regards a fair construction of tax bases, tax rates, allowances and incentives. Such disagreement is initially discerned at the legislative level, with different governments pursuing substantially different tax policies in the course of a few years.

Globalization complicates the scenario from an international perspective. Different national legislatures, constrained by divergent national circumstances and needs, tend to adopt diverse views on the elements of what a sound tax system should be. Competition among taxing jurisdictions seeking to attract economic activity and boost development also leads to incoherent national tax laws interacting in an international tax arena. This is the context in which multinational taxpayers are required to construe the spirit of the several (national and international) tax laws to which they are subject. There does not seem to be international consensus on basic tax-related notions (for example, the link between passive income and taxing jurisdiction).[45] Equally, there is no clear guidance on the extent to which a legislature's intention to provide tax incentives to business in their jurisdiction should be taken into account.

An illustrative example of an intercontinental fight over the proper application of international tax principles is found in the area of fiscal state aid.[46] In August 2016, the European Commission decided to cancel an advance pricing arrangement (APA) between Ireland and the local subsidiary of Apple, ordering the latter to pay EUR 13 billion to the Irish State.[47] It was argued that the agreement embodied in the APA for the evaluation of intra-group transactions infringed EU State aid provisions, conferring an unfair tax advantage on the taxpayer. The United States – the residence jurisdiction of the parent company – reacted fiercely to the decision, alleging that it was based on a novel application of the international standard of the arm's length principle.[48]

At the current stage of international tax law, discerning the spirit of tax law appears to be a difficult mission with no guarantee of success. The radical changes brought about to economic reality by globalization and digitalization should also be duly taken into account. A standalone obligation of taxpayers to comply with the spirit of tax law and demonstrate such compliance runs the risk of producing the opposite result of what was intended. A lack of sufficiently precise language in tax legislation, the absence of international consensus on proper taxation, as well as a total lack of tax legislation on new types of economic activities can lead to significantly diverse interpretations. Within such a framework, tax compliance seems a rather utopian objective. At the same time, the threat of tax uncertainty is significantly increasing.

7. The Way Forward – Suggestions

The above analysis evidences that the spirit of the law is too vague a concept to be effectively used in taxation. As such, legislatures should abstain from providing for an express obligation for taxpayers to comply with the spirit of tax law. Beyond an express standalone obligation, however, modern legislatures increasingly opt for tax avoidance legislation,[49] which is, itself, a source of prolonged debate. By definition, such legislation must make reference to broad, unclear notions, allowing administrations discretion to assess transactions on a case-by-case basis. Consequently, taxpayers are effectively being deprived of the fundamental right to legal and tax certainty, i.e. the right to be able to predict the tax treatment of their affairs, make plans and freely choose which activities to engage in. Such a right, however, is a mainstay of democracy; it marks the line between free and despotic countries.[50]

To pay tribute to taxpayer rights, legislatures should ensure that any tax avoidance laws are accompanied by certain indispensable safeguards. First and foremost, it should be clear that tax planning, in itself, is appropriate and necessary. It allows taxpayers to navigate a vast and complex international tax sphere and ensure fulfilment of tax obligations, while making use of the tax incen-

case. *See* M. Gordon et al., *The Letter Versus the Spirit of the Law: A lay perspective on culpability*, 9 Judgm. Decis. Mak. 5, 480 (2014).

44. The first tax ever imposed was the *corvée*, i.e. forced labour imposed on those too poor to pay any other form of tax. It is worth noting that, for ancient Egyptians, the terms used for "labour" and "tax" were regarded as synonyms; *see* D. Burg, *A World History of Tax Rebellions: An Encyclopedia of Tax Rebels, Revolts and Riots from Antiquity to the Present* (Taylor & Francis 2004) and R. Nozick, *Anarchy, State and Utopia* (The Perseus Books Group 1977).
45. *See* Valente, *supra* n. 15, at 4.
46. *See* L. Gormsen, *EU State Aid Law and Transfer Pricing: A Critical Introduction to A New Saga*, 7 JECL & Pract. 6 (2016).
47. Commission Decision (EU) 2017/1283 of 30 August 2016 on State SA 38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple, OJ L 187 (2017).
48. US Department of the Treasury, *The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings*, White Paper (24 Aug. 2016), available at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/White-Paper-State-Aid.pdf (accessed on 30 Nov. 2017).
49. Examples include the EU Member States, which must transpose relevant legislation in their national legislation by the end of 2018 in accordance with the ATAD Directive, as well as the United Kingdom, which enacted a GAAR in 2013, and Australia, in 2016.
50. According to Hayek, "Nothing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principle known as the Rule of Law. Stripped of all technicalities, this means that government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances and to plan one's individual affairs on the basis of this knowledge". *See* F. Hayek, *The Road to Serfdom* (University of Chicago Press 1944); *see also* R. Cunha, *supra* n. 33, at 8.

tives and allowances provided (and intended as such) in the legislation. Reasonable tax planning should thus be clearly excluded from the scope of tax avoidance rules. In addition, the application of tax avoidance rules should be limited to tax laws that are unambiguously drafted, i.e. those that do not allow for more than one interpretation.[51]

Furthermore, due care should be taken with regard to the text of tax avoidance provisions. It should contain and clearly reveal the legislative purpose. It should also restrict its scope to situations in which a clear intention to reduce tax liability may be discerned. Tax administrations should be charged – at least in principle – with the burden of proof regarding the existence of facts justifying the application of the rules. Taxpayers should be entitled to introduce evidence to defend their position. An independent committee should be established, with the duty to express its opinion on the application of the law to the facts of each case and supervise the procedure. Decisions should be made by properly qualified and experienced officials, and taxpayers should have the right to appeal against any decisions.[52] Finally, detailed guidelines should be provided on the scope and proper application of tax avoidance legislation, along with a procedure to obtain advance tax rulings on such application with regard to specific factual and legal circumstances.

51. G. Aaronson, *GAAR Study: A Study to Consider whether a General Anti-Avoidance Rule Should be Introduced into the UK System*, Report by Graham Aaronson QC, 8, UK Government Archive (2011, supplemented 2012).
52. Id.

8. Conclusion

To sum up, the purpose of this article was to explore the obligation to comply with the spirit of the law in the context of taxation. Such an obligation implies that taxpayers should align their conduct with the express purpose of tax legislation, the purpose implied in the past, as well as what can be expected to apply based on current circumstances. Due to the controversial nature of tax law and the intrinsic vagueness of the notion of the spirit of the law, it seems that any express reference to the latter should be left out of tax legislation. It should be recognized, however, that an important body of legislation has already been enacted (or is currently under consideration) in several jurisdictions to clamp down on non-compliance with the spirit of tax law with the aim of unacceptably reducing a taxpayer's tax bill. Such legislation is highly questionable, in itself, as it is deemed to challenge the fundamental principles of democratic states. Should such legislation nevertheless be put in place, it should include a number of guarantees, as well as check-and-balance provisions, to prevent its abusive application at the expense of taxpayer rights.

In any event, the drafters of tax legislation should not shirk their own responsibilities while increasing those of taxpayers. Appropriate drafting of tax legislation, which does not allow for controversial interpretations and can be effectively applied in the same way by all users of the law – taxpayers and tax administrations – is within a legislature's power and is one of their specific obligations. It is high time they take up the challenge in a serious and diligent manner.